

**Pls note: the following subject to be added to future contracts for purchasing Currents Units:**

**“Subject to the buyer, at buyer’s expense, getting approval from their Lawyer or Accountant regarding tax status on rental income for the subject property by xxxx, 2011. This subject is for the sole benefit of the buyer(s).”**

## **Classifying Strata Accommodation Property** (as of Nov 1 2011 from BC Assessment website)

### **Introduction**

Historically, BC Assessment was required to place strata lots used for short-term overnight commercial accommodation in Class 6 – business and other if the strata lots were (i) part of a strata plan comprised of 20 or more strata lots, (ii) rented or offered for rent for periods of less than 7 days for the majority of the year, and (iii) substantially controlled by a single rental accommodation manager.

A new classification methodology was brought into force in 2007 that permits “strata accommodation properties” to be split-classified between Class 6 and Class 1 – residential to more accurately reflect the dual use of these properties (i.e., personal residential and commercial rental use).

### **What is a “strata accommodation property”?**

A strata accommodation property (or SAP) is defined in section 19(1) of the Assessment Act to mean a strata lot that is in a strata plan or contiguous strata plans comprised of 20 or more strata lots, and which is rented or offered for rent as overnight accommodation for periods of less than 28 days for at least 20% of the 12-month period ending June 30. If a strata accommodation property meets the additional conditions set out in B.C. Reg. 438/81 (e.g., owner’s right to use), the strata accommodation property will be split-classified between Class 1 and Class 6 in accordance with the property’s actual use. Only that proportion of time the strata accommodation property is actually rented on a short-term basis will be attributed to Class 6. The remainder of time will be attributed to Class 1. In addition, up to 36 days of short-term rental use will be treated as “residential use”.

For example, a strata accommodation property will be split-classified according to the following formula:

$$\text{Class 1 value} = \frac{([\text{365} + \text{36}] - \text{BU}) \times \text{V}}{365}$$

$$\text{Class 6 value} = \text{V} - \text{Class 1 value}$$

Where:

**BU** = the number of reported commercial rental days or 36, whichever is greater, and

**V** = the value of the strata accommodation property in \$

So a strata accommodation property valued at \$400,000 and actually rented as short-term overnight accommodation for 100 days between July 1, 2008 and June 30, 2009, will be split-classified as follows on the 2010 assessment roll:

Class 1 value (rounded): \$329,000

Class 6 value (rounded): \$70,100.

### **What is not a “strata accommodation property”?**

The following strata lots are not strata accommodation properties and will not receive split classification:

- strata lots used or available solely for parking or storage or other similar commercial purposes (Class 6);
- overnight accommodation strata lots within strata plans of fewer than 20 strata lots (Class 1);
- strata lots within strata plans of 20 or more strata lots, but which are used or available solely for monthly rentals (Class 1);
- strata lots within strata plans of 20 or more strata lots which are used for short-term rentals but for less than 20% of the year ending June 30 (Class 1).

**What is the effect of fractional ownership on strata accommodation property?**

The conditions that must be met to benefit from split classification apply to the entire strata accommodation property (i.e., the legal parcel). BC Assessment will consider the use reported by any fractional owners of a strata accommodation property. Accordingly, the classification of the strata accommodation property will be affected by other fractional owners' use of that property. The ultimate class split will depend on the sum of all the owners' reported usage and not an individual owner's usage.

**What is the relevant reporting period?**

The relevant reporting period is July 1 – June 30 prior to completion of the assessment roll (e.g., July 1, 2008 – June 30, 2009 for the 2010 tax year).

**What is the annual reporting deadline?**

The information required to determine the appropriate split classification, if any, must be reported by August 31 each year. This means owners (or rental accommodation managers) will have two months from the end of the reporting period to report usage of their strata lot to BC Assessment.

**What if I fail to provide the required information?**

The strata accommodation property will be placed entirely in Class 6 on the next assessment roll if the usage information is not provided to the assessor by the deadline.

**What if I own multiple strata accommodation properties within a strata complex (strata plan)?**

This classification methodology is intended to apply to widely-owned strata complexes. If an owner wholly owns more than 14 strata accommodation properties in a strata plan or contiguous strata plans, those strata lots will be excluded from Class 1 and will be entirely in Class 6. Furthermore, if the owner is a corporation, its affiliates constitute owners for these purposes.

**Are there special considerations for strata lots formerly in Class 1 – residential based on the wording of B.C. Reg. 438/81 before the 2007 amendments?**

Owners of strata lots which, as of October 31, 2007, met the criteria formerly set out in B.C. Reg. 438/81 may continue to have their strata lots “grandfathered” entirely in Class 1 under s. 19.1 of the Assessment Act.

These strata lots will continue to be grandfathered into Class 1 in future tax years if all of the following criteria are met each year:

1. The strata lot must be entirely in Class 1 the previous tax year by virtue of meeting the grandfathering criteria.
2. The strata lot must be part of a strata plan or contiguous strata plan including 20 or more strata lots.
3. The strata lot must be used or available for overnight accommodation.

4. In addition, the strata lot must meet one of the two following criteria:

(a) as of June 30, it must not be available for rent for periods of less than 7 days for 50% or more of the year ending on June 30 prior to the tax year; or

(b) as of October 31, it must not be controlled or managed by one or more persons who control or manage 85% or more of the strata lots in the strata plan or contiguous strata plans.

The grandfathered status will be lost if the criteria are not met in each taxation year. Once lost, if a strata lot meets the definition of strata accommodation property, it will be split classified depending upon its actual use as reported by the owner or the rental accommodation manager on behalf of the owner.

**Checklist for Classifying Strata Accommodation Property** found [here](#).

## Checklist for Classifying Strata Accommodation Property (SAP)

### Grandfathering Short-Term, Overnight Accommodation Strata Lots

**Note:** these questions apply only to strata lots that have been continually grandfathered into Class 1 since the 2008 assessment roll.

1. Is the strata lot part of a strata plan or contiguous strata plans of 20 or more strata lots and used or available for overnight accommodation? Contiguous means in close proximity and generally adjacent. However, an intervening roadway would not necessarily preclude a conclusion that two strata plans are contiguous.

Yes: Go to Question 2

No: Place the strata lot entirely in Class 1

2. As of June 30, was the strata lot rented or offered for rent as overnight accommodation for periods of less than 7 days for at least 50% of the year ending June 30?

Yes: Go to Question 3

No: Place the strata lot entirely in Class 1

3. As of October 31, was the strata lot managed or controlled by a person who controls or manages 85% or more of the strata lots in the strata plan or contiguous strata plans

Yes: Refer to the questionnaire for Split Classification of SAPs

No: Place the strata lot entirely in Class 1

## 2. Split Classification of SAPs

**Note:** these questions apply to strata lots have been constructed since 2008 or which never qualified or no longer qualify to be grandfathered.

1. Is the strata lot part of a strata plan or contiguous strata plan of 20 or more strata lots? Contiguous means in close proximity and generally adjacent. However, an intervening roadway would not necessarily preclude a conclusion that two strata plans are contiguous.

Yes: Go to Question 2

No: The strata lot is not a SAP. Place the strata lot entirely in Class 1

2. Was the strata lot rented or offered for rent as overnight accommodation for periods of less than 28 days for at least 20% of the year ending June 30?

Yes: Go to Question 3

No: The strata lot is not a SAP. Place the strata lot entirely in Class 1.

3. Did the owner have the right to use the strata lot for at least 7 days between July 1 and the following June 30 (check for restrictive covenants)?

Yes: Go to Question 4

No: Place the strata lot entirely in Class 6

4. Did an owner use the strata lot for at least 7 days between July 1 and the following June 30

Yes: Go to Question 6

No: Go to Question 5

5. Did the owners of a majority of the strata lots in the strata plan or contiguous strata plans use their strata lots for at least 7 days between July 1 and the following June 30?

Yes: Go to Question 6

No: Place the strata lot entirely in Class 6

6. Did the owner report the usage information to BC Assessment by August 31 (i.e. the number of days the strata lot was rented as overnight accommodation, the number of days the owner had the right to use the strata lot and the number of days the owner used the strata lot)?

Yes: Go to Question 7

No: Place the strata lot entirely in Class 6

7. Does the owner wholly own more than 14 SAPs in the strata plan or contiguous strata plans (including any SAPs owned by an affiliate if the owner is a corporation)?

Yes: Place the strata lot entirely in Class 6

No: Split classify the strata lot between Class 1 and Class 6 using the following formula

$$\text{Class 1 value} = [ (401 - \text{BU}) \div 365 ] \times V$$

$$\text{Class 6 value} = V - \text{Class 1 Value}$$

Where:

BU = the number of reported business/rental days or 36, whichever is greater, and

V = the actual value of the strata lot in \$

# **FRACTIONAL INTEREST REAL ESTATE PROJECTS**

## **AN INTRODUCTION TO THE LEGAL STRUCTURE**

*By Sara E. Pope*

### **Introduction**

Fractional interests are an increasingly popular way of developing and selling recreational and resort properties in British Columbia. It is common to see projects offered as “quarter shares” or in fractions of sixths, twelfths or even fifty-firsts. Buyers are motivated to pay a price for recreational property that reflects the amount of usage the buyer will actually make of the property or to pay a price that buys them more “sizzle” or luxury than they could afford if they bought the whole interest in the property.

The purpose of this paper is to introduce the basic legal structure that creates the interests in a fractional interest project that buyers buy and lenders use as security. Other than the fact buyers can purchase an interest that is less than 100% of the fee-simple interest in a strata lot, a fractional interest project is essentially the same as any other condominium project. All provisions of the *Strata Property Act* apply: buyers are members of the strata corporation, a strata council is elected, a property manager is appointed, there is an annual budget for the strata corporation, there is common property, limited common property, etc. The legal structure and documents that create the fractional interests are in addition to the standard condominium provisions.

### **What Does a Buyer Get?**

A buyer of a fractional interest gets three things:

1. A fee-simple title interest. The buyer is the registered owner on title to the strata lot as to the fraction of the buyer’s interest (i.e. 25%).
2. A sublease (which sets out the period of time the buyer can use the strata lot).
3. One share in the Owners Corporation.

Each of the above represents one of the components of the legal structure creating fractional ownership interests.

### **Title**

Each buyer of a fractional interest becomes a registered owner in fee-simple of an interest in the strata lot. If the project is sold on a quarter share basis, each buyer receives an undivided one-quarter interest as a tenant in common in the title to the strata lot. The buyer’s name will appear on title as the registered owner of the buyer’s fee-simple interest.

### **Headlease and Sublease**

In a quarter share project there may be as many as 4 different owners of a quarter interest in a strata lot, each having an undivided one-quarter interest, as tenants in common. Because there is more than one

owner and the owners are usually at arms-length to each other, a mechanism is needed to provide for the orderly use of the strata lot by all of the owners.

The lease aspect of the fractional interest program provides this organizational mechanism. After the strata plan is registered and before the first sale to a buyer, a headlease in favour of the "Owners Corporation" is registered against title to each strata lot participating in the fractional interest program. The headlease grants the Owners Corporation the right to the use and possession of the strata lot for a period of time, such as 199 years. The Owners Corporation then grants a sublease of this headlease to each buyer of a fractional interest in the strata lot. The sublease establishes the buyer's right to the use and possession of the strata lot. Both the headlease and the sublease are registered in the Land Title Office and show as a charge on the title to the strata lot.

A summary of some of the important aspects of the sublease is as follows:

1. The sublease is granted by the Owners Corporation to the buyer at the same time the buyer becomes the registered owner of a fee-simple interest in the strata lot. The conveyance is made in accordance with standard conveyancing practice and the buyer's ownership of both the fee-simple interest and the sublease are registered in the Land Title Office.
2. The sublease is for the same term as the headlease (for example, 199 years) and gives the buyer the right to occupy the strata lot. For instance, in a quarter share project a buyer would have the right to occupy the strata lot for a minimum of twelve weeks in each calendar year (or one week per month). A calendar is attached to the sublease that sets out the weeks of occupation for each quarter interest owner for an initial period, such as 5 years. The Developer will usually designate Thursday, Friday, or Saturday as the change over day for the expiry and beginning of each owner's period of use.
3. The rent for the sublease is nominal (such as \$10 for the 199 year term) and is prepaid. However, the sublease requires the owners to pay the costs incurred by the Owners Corporation in operating the fractional interest program and maintaining the strata lot. Owners also pay to the Owners Corporation the owner's proportionate share of the costs of owning real property, such as, strata maintenance fees, real property taxes, utilities, special assessments due to the strata corporation, etc. Requiring owners to pay these costs directly to the Owners Corporation, who in turn pays the proper authority, assures all owners the bills are being paid and each owner is paying their proportionate share.
4. If an owner is in default under the sublease because, for instance, the owner has not paid their share of the expenses, the sublease provides that the owner forfeits their right to occupy the strata lot during their period of use and the Owners Corporation can rent out the strata lot during such period to recover the unpaid contribution to expenses.
5. Owners may sell their interest at any time provided the owner is not in default of the sublease and the owner at the same time assigns his rights under the sublease, transfers the fee-simple interest in the strata lot and transfers his shares in the Owners Corporation to the new owner.

### **Owners Corporation and Strata Corporation**

The Owners Corporation functions similarly to a "strata corporation" and is used to manage and administer the fractional interest program. All buyers of a fractional interest automatically become a member of the Owners Corporation. A buyer gets one share in the Owners Corporation per fractional interest purchased.

The Owners Corporation is a company incorporated under the British Columbia *Company Act*. The articles of the Owners Corporation are different from standard company articles and are made to address those issues particular to the fractional interest project. Owners are entitled to vote on matters concerning the Owners Corporation, including the election of a Board of Directors and the annual Owners Corporation Budget at each annual general meeting of the Owners Corporation.

All fractional interest owners are also members of the strata corporation. The *Strata Property Act* provides that each strata lot has only one vote at meetings of the strata corporation. Typically the articles of the Owners Corporation or the terms of the sublease provide for how the vote at the strata corporation meetings will be exercised.

The following is a summary of some of the differences between and similarities of the Owners Corporation and a strata corporation:

1. Under the British Columbia *Strata Property Act*, a “strata corporation” is created when a strata plan is filed in the Land Title Office. As provided by the *Strata Property Act* all the owners of the strata lots in that strata plan are automatically members of the strata corporation. A strata corporation is governed by the *Strata Property Act*.
2. The Owners Corporation is a company created under the British Columbia *Company Act*. Its incorporation documents are on file with the Registrar of Companies in Victoria and is governed by the requirements of the *Company Act* and its articles of incorporation. The Owners Corporation must file annually certain documents with the Registrar of Companies in order to remain in good standing. An owner must be a shareholder to be a member of the Owners Corporation.
3. Simply stated, the strata corporation is responsible for all matters that are external to the strata lot, such as the common property and building exteriors. The budget of a strata corporation typically provides for landscaping and maintenance, fire insurance, garbage removal, common area hydro, window cleaning, chimney cleaning, etc.
4. The Owners Corporation is responsible for all matters that are internal to the strata lot and for the operation of the fractional interest program. The Owners Corporation budget provides for reserves for the furnishings, maintenance and repairs to the interior of the strata lot, utilities, property taxes, strata fees, contents insurance, etc.
5. A strata corporation has a strata council and the Owners Corporation has a board of directors. The council is elected from the members of the strata corporation and the board of directors is elected from the members of the Owners Corporation.
6. Both usually retain the services of a professional manager to assist them with their obligations and functions.
7. Both have a budget for those costs relevant to their functions. The budgets are set at the annual general meetings of the members of the strata corporation or the Owners Corporation, as the case may be.

### **Owners Corporation Manager**

The developer of a fractional interest project arranges for the Owners Corporation to retain a manager to manage and administer the affairs of the Owners Corporation and by extension, the strata lots in the fractional interest program. Typically, the Owners Corporation enters into the management agreement

with the manager while the developer still controls the shares in the Owners Corporation. The manager is paid for its services in accordance with the terms set out in the management agreement. The services of the manager would include the following:

1. **Owners Corporation Services:** These services involve managing the corporate structure of the Owners Corporation, arranging for the legal and auditing functions of the Owners Corporation, managing key pick-up and drop off services for owners, collecting assessments from owners, paying all authorized disbursements (i.e. the real property taxes, strata maintenance fees, utilities, etc.).
2. **Full Management Services:** These services involve conducting change-over cleanings, arranging for an annual clean of each strata lot, replacing furniture, fixtures and equipment, repairing any damage caused by an owner beyond normal wear and tear, collecting the appropriate reserves, and generally carrying out the overall supervision and management of the interior of the strata lots.

### **Owners Corporation Budget**

At the annual general meeting of the Owners Corporation the owners vote on and approve an Owners Corporation Budget for the next fiscal year. Owners are required by the sublease to pay monthly their share of the Owners Corporation Budget. These payments are in addition to the monthly contributions owners make to the strata corporation. A typical Owners Corporation Budget would provide for the following expenses:

1. **Fixed Ownership Expenses:** These expenses are those incurred as a result of being the registered owner of property. Examples of these expenses are as follows:
  - Cable, Telephone & Utilities
  - Content & Liability Insurance
  - Property Taxes
  - Strata Fees
2. **Owners Corporation Expenses:** These expenses relate to providing the “Owner’s Corporation Services” (as described above). In particular these are expenses that relate to maintaining the fractional interest program and the associated structure of the Owners Corporation.
3. **Full Management Expenses:** These expenses relate to providing “Full Management Services” (as described above). In particular these are expenses that relate to the management and maintenance of the interior of each strata lot. Examples of these expenses are as follows:
  - Annual Clean: Typically strata lots are subject to a thorough clean and repair program that occurs once a year over a several day period.
  - FF&E Reserve: The FF&E (“Furniture, Fixtures and Equipment”) Reserve is a replacement reserve to be used for the long-term repair and maintenance of the in-unit furnishings.
  - Change-Over Cleaning Expense: This expense relates to the cost of the “change-over clean” done each time a strata lot is vacated following usage of the strata lot by an owner.

## Summary

The various components creating the structure of a fractional interest project are designed to give each owner certainty in respect of the time an owner may use their strata lot and to manage the payment by each of owner of their proportionate share of the expenses necessary to maintain and operate the fractional interest program. The headlease/sublease and the Owners Corporation are the tools used to safeguard each owner's interest within a structure that arranges for the ownership of less than a 100% fee-simple interest in a strata lot.

*This paper provides a summary and overview of the law only. For specific advice, refer to the Acts mentioned above, or seek specific legal advice.*



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